Office-Supreme Court, U.S.
FILED
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ALEXANDER L. STEVAS,
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NO. 85-150

In the Supreme Court of the United States

OCTOBER TERM, 1985

CHEVRON U.S.A. INC.,

Petitioner,

VERSUS

BELCO PETROLEUM CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED[1]

1. May an Appellate Court—without violating F.R.C.P. 52(a) as interpreted in *Anderson v. City of Bessemer City, North Carolina*, 105 S.Ct. 1504 (March 19, 1985)[2]—substitute its judgment for that of the Trial Court on the issue of the intention of the parties to a contract or is the Appellate Court instead required first to hold that the judgment of the Trial Court was clearly erroneous?

2. May an Appellate Court substitute its judgment for that of the Trial Court when the Appellate Court does not stop at the four corners of the contract but also examines extrinsic evidence and draws inferences therefrom diametrically opposed to those drawn by the Trial Court?

3. Was not the decision of the Court of Appeals on the merits contrary to Louisiana law?

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[1] The caption to the case contains the names of all parties. Chevron Corporation. InterNorth Inc. and Northern Natural Gas Co. are companies related to the parties.

[2] *City of Bessemer* was decided on March 19, 1985, only six days before the decision of the Fifth Circuit and so could not have been considered by that Court in connection with its original opinion. It was cited and argued to the Fifth Circuit on Application for Rehearing.

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NO.

IN THE SUPREME COURT OF THE UNITED STATES
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CHEVRON U.S.A. INC.,

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BELCO PETROLEUM CORPORATION,

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PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Chevron U.S.A. Inc. ("Chevron") petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The denial of rehearing by the Court of Appeals (App. A) is not reported. The opinion of the Court of Appeals (App. B) is reported at 755 F.2d 1151. The opinion of the District Court (App.C) is not reported.

JURISDICTION

The judgment of the Court of Appeals was entered on March 25, 1985 (App. B). Rehearing was denied on April 25, 1985 (App.A). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Rule 52(a) F.R.C.P., reads (in pertinent part):

> Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.

28 U.S.C. § 1254(1) (1980) provides:

> Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:
>
> (1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree...

Also involved are Louisiana Civil Code Articles 2046, 2054, and 2055 which are quoted in the Appendix.

STATEMENT

Chevron paid $770,000 bonus to the United States for an offshore oil and gas lease. In 1971 Chevron assigned the lease to Belco, reserving a one-eighth overriding royalty. Belco owed this royalty in cash or in kind. Belco discovered gas and found a market. Chevron wished to take its royalty gas in kind and to make its own sale of this gas. Chevron and Belco entered into a gas balancing agreement which provided that, if a party did not dispose of its share of gas, the other could take more than its share, but had to maintain a "gas in storage" account reflecting its draw of the other's gas. The underproducing party could at any time choose to begin taking and selling its share, plus 25% of the overproducer's share, until the account was in

balance. Because of an inordinate delay in receipt of an FPC (now FERC) certificate and because the reserves turned out to be far less than either Chevron or Belco had expected, the field depleted before Chevron began taking its share of gas. The contract was silent with respect to whether the underproduced party would be entitled to a cash accounting if the field depleted before such party had received its share of the gas. Chevron demanded such accounting. Belco refused. This suit was brought in State Court and removed to the Federal District Court pursuant to 28 U.S.C. § 1441. Jurisdiction was based on 28 U.S.C. § 1332.

The trial judge, a Louisiana lawyer versed in the application of the articles of the Louisiana Civil Code, held that the silence of the parties with respect to cash accounting on field depletion constituted an ambiguity in the contract and a failure by the parties to express in their contract their intention with respect to such accounting.[3] The Court of Appeals reviewed this holding without any finding that it was clearly erroneous. Reaching the opposite result, the Court of Appeals held that the absence of a cash balancing provision constituted conclusive evidence of the mutual intent of the parties to exclude cash balancing on early field depletion.

The Court of Appeals, however, did not limit itself to an analysis of the four corners of the contract. Going outside the contract, it noted that Chevron had deliberately omitted a cash accounting provision from the contract.

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[3] In accordance with La. Civil Code Arts. 1903 and 1945, now recodified as Arts. 2054-2055, the trial judge, after holding that the contract did not express the intention of the parties, applied equitable principles of unjust enrichment to supply the incident of the contract about which the parties had been silent. He then granted judgment for Chevron for the amount for which Belco had sold Chevron's gas.

It rejected—though the Trial Court had accepted—Chevron's explanation of its intent in omitting the clause. The Appellate Court drew inferences from the facts surrounding the execution of the contract which were diametrically opposed to the inferences drawn by the trial judge. The Appellate Court did not say that any of the findings of fact made by the able trial judge were clearly erroneous.

REASONS FOR GRANTING THE WRIT

1) This Court stated in *City of Bessemer* that a finding of fact, particularly one with respect to the intention of parties, is binding in an Appellate Court unless clearly erroneous *even when the finding is based on documentary evidence alone.* This proposition completely removes the underpinning of the former notion that an Appellate Court, in the absence of a clearly erroneous finding, can substitute its judgment for that of the trial judge with repect to the issue what a contract means and what the parties intended thereby.

Professor Corbin has stated:

> [T]he question of what is the meaning that should be given by a court to the words of a contract is a question of fact, not a question of law. *Corbin on Contracts,* § 554.

Professor Williston has stated:

> It is obvious that the meaning of language is a question of fact. The code or standard by which it is sought to test the meaning must be discovered frequently by evidence of the

> facts and circumstances concerning the making of the contract. Even though the question concerns merely the normal meaning of a word as found in dictionaries, it is still a question of fact, if the word "fact" is used in a truly literal sense. *Williston on Contracts*, § 616.

The *Restatement (second) Contracts*, § 212, Comment (d), p. 127, notes that, partly because (in the past) jurors were often illiterate, questions of the interpretation of language were treated as questions of law. The Restatement does not oppose this position but concedes:

> Analytically, what meaning is attached to a word or other symbol by one or more people is a question of fact.

On an earlier day, the Fifth Circuit said:

> [D]eciding what is the meaning of the contract is a question of fact. *Dobson v. Masonite Corp.*, 359 F.2d 921, 924 (5th Cir. 1966).

If the meaning to be attached to words in a contract is a question of fact, the meaning to be attached to silence—the omission of words—is at least as much a question of fact.

That the determination of the meaning of a contract is a question of fact does not mean that meaning of the contract is necessarily determined by the trier of fact. Professor Corbin states:

> As in the case of all other matters of fact, we

> can here lay down the rule that if the evidence is so clear that no reasonable man would determine the issue before the court in any way but one, the court will itself determine the issue, either by directing the verdict or by dispensing with any verdict whatever. *Corbin on Contracts,* § 554.

Though Professor Corbin states that the interpretation of a contract is a question of fact, he acknowledges that it has often been said that such interpretation is "a question of law for the Court." *Corbin on Contracts,* § 554. That position, rejected by Corbin, is inconsistent with this Court's decision in *City of Bessemer.* The clear import of *City of Bessemer* is that a Trial Court's findings with respect to the intention of parties, even though made solely from perusal of documentary evidence, should be accepted by a Court of Appeals unless "clearly erroneous." Justice Blackmun's concurrence, however, labels that portion of the majority opinion as "dictum," and since the record there contained "far more documentary evidence," this creates a hiatus on the important question of the application of Rule 52(a) to the interpretation of contracts. Does Rule 52(a) admit of "exceptions or purport to exclude certain categories of factual findings" (e.g., finding based on documentary evidence) from the command of the Rule? *Cf. Pullman - Standard v. Swint,* 456 U.S. 273 at 287 (1982).

The language of Justice White's majority opinion plainly contemplates that no factual findings would be free of the "clearly erroneous" test; that no invidious distinctions ought to be drawn as to differently based factual findings. This does not mean that the Court of Appeals might not have an easier task in pointing out "clear error" in a finding based solely on documentary evidence. But it does

mean that the Appellate Court must accord respect to the District Court's findings and not merely substitute its preferred result. Otherwise the trial on the merits in a case involving documents would indeed be merely "...a tryout on the road."

Here, the Court of Appeals founded its logic on the proposition that the "clearly erroneous" rule did not apply where only documentary evidence was involved. This finding was, itself, "clearly erroneous" if *City of Bessemer* means what it says. It is important to the proper administration of justice that a Court of Appeals be able to understand and follow the commands of Rule 52(a). Whether or not the clear language of *City of Bessemer* is *obiter,* it is important that any hiatus be closed and the issue decided.

2) The Court of Appeals' holding is that the facial interpretation of a contract is not subject to the clearly erroneous standard, thus ruling that no extrinsic evidence should have been considered by the Trial Court. But the Trial Court *did* consider extrinsic circumstances in reaching its findings of the intent of the parties, and the Court of Appeals *did* consider the same evidence, as the opinion clearly reflects. Thus, even were *City of Bessemer's* holding to be limited so as not to apply the "clearly erroneous" test to findings based *solely* on documentary evidence, that case would still require a Court of Appeals to give respect to the District Court's findings based on the documentary evidence as interpreted in the factual context of the extrinsic evidence. An Appellate Court may not facilitate its reversal of factual findings of a Trial Court by denominating its procedure as "facial interpretation" when its opinion, on its face, utilizes the extrinsic evidence relied

upon by the Trial Court.

3) The holding of the Court of Appeals was plainly wrong. In addition to disagreeing with the "judgment calls" of the district judge, the Appellate Court misunderstood and misapplied Louisiana Civil Law. Article 2054 of the La. Civil Code as amended by Act 331 of 1984 reads (with its official comment) as shown in Appendix F. The plain language is that when a contract makes no provisions for a particular situation, the Court is to supply the deficiency according to equity and usage. Here, the District Court, after hearing all the extrinsic evidence, found that the contract did not cover the particular circumstance and that a cash balancing was to be applied in order that the balancing agreement might "achieve its purpose" (Art. 2054, La. Civil Code). The District Court also found that to infer that Chevron *intended* to waive its right to receive its overriding royalties would lead to an "absurd consequence" (Art. 2046, La. Civil Code). No such donative intent could be discerned in the balancing agreement. These findings, based on the district judge's knowledge of local law and custom and the evidence before him, were reversed by the Court of Appeals in a *de novo* review of the findings. The reversal involved making a fundamental factual determination that the presumed eleemosynary intent on Chevron's part was not an "absurd" conclusion, and the making of a finding that such an intent was clearly expressed by the bare words of the contract.

The Appellate Court applied an overly simplified test of "exclusion by inclusion"—saying that the contract supplied the exclusive method by which a balancing would occur. In so doing, it lost sight of the main objective of the

agreement—that a balance would be established. For the contract to "accomplish its purpose" (*cf.* Art. 2054, La. Civil Code) a balance must occur. For a balance to occur in the case of early exhaustion of reserves, cash balancing would be necessary. To assume that Chevron intended to waive its right to its overriding royalty is to fly in the face of human (and corporate) nature. The Court of Appeals' decision thus, does, in fact, lead to an "absurd" result.

CONCLUSION

If this Court meant what it said in *City of Bessemer,* then an Appellate Court, without a clearly erroneous finding, cannot substitute its judgment for that of the Trial Court on the question of the intention of the parties even when that intention is ascertained from the facial interpretation of a contract. The Fifth Circuit did so in this case. This Court should vacate the decision below and remand for the Court below to decide the case by applying the clearly erroneous standard.

If this Court did not mean—as it said in *City of Bessemer*—that under F.R.C.P. 52(a) findings of fact based on documentary evidence alone may be reversed on appeal only if clearly erroneous, then this Court should hold that its former language was dicta, not to be followed. Whether an Appellate Court may substitute its judgment in a case like this one is not only a question which has been subject to great dispute,[4] it is a question central to defining the role of a Court of Appeals, and a question which, if answered consistently with *City of Bessemer,* will con-

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[4] In addition to the authorities cited in the text, see *Meyers v. Selznich Co.,* 373 F.2d 218 (2d Cir. 1966); Weiner, *The Civil Jury Trial and the Law-Fact Distinction,* 54 Calif. L. Rev. 1867, 1930 (1966).

tribute greatly to judicial efficiency.

All of which is repectfully submitted.

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APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 84-3410

CHEVRON U.S.A., INC.
Plaintiff-Appellee,

versus

BELCO PETROLEUM CORPORATION,
Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of Louisiana

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ON PETITION FOR REHEARING AND SUGGESTION FOR REHEARING EN BANC

(Opinion: MARCH 25, 1985, 5 Cir., 198__, ____F.2d____)

(April 25, 1985)

Before THORNBERRY, REAVLEY and HIGGINBOTHAM, Circuit Judges.

PER CURIAM:

(xxx) The petition for Rehearing is DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Federal Rules of Appellate Procedure

(Appendix A continued)
and Local Rule (35) the Suggestion for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ Patrick E. Higginbbotham
United States Circuit Judge

APPENDIX B

CHEVRON U.S.A. INC.,
Plaintiff-Appellee,
v.
BELCO PETROLEUM CORPORATION,
Defendant-Appellant.

No. 84-3410.

United States Court of Appeals,
Fifth Circuit.

March 25, 1985.

Oil and gas lessee of federal offshore lease brought suit against farmout agreement driller after driller refused demand from lessee for cash payment of one eighth of the revenues from sale of gas. The United States District Court for the Eastern District of Louisiana, A.J. McNamara, J., awarded lessee over $600,000 for gas that lessee was entitled to take from an offshore gas well under a "gas balancing" contract but did not take before well went dry. Driller appealed. The Court of Appeals, Patrick E. Higginbotham, Circuit Judge, held that: (1) given specific designation of a particular method of "in kind" balancing as proper way of reconciling gas account, there was no room for contention that parties left open possibility that cash balancing or some other form of balancing might nonetheless be used; (2) because contract, on its face, only provided for "in kind" balancing, driller breached on contractual duty to lessee when it refused to pay lessee in cash; and (3) "gas balancing" contract was not a consumption loan agreement, which would obligate driller either to restore gas "loaned"

or to pay for it.

Reversed.

Appeal from the United States District Court for the Eastern District of Louisiana.

Before THORNBERRY, REAVLEY, and HIGGINBOTHAM, Circuit Judges.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

Applying Louisiana law, the district court awarded Chevron U.S.A. Inc. over $600,000 for gas that Chevron was entitled to take from an offshore gas well under a gas balancing contract but did not take before the well went dry. The district court decided that the parties had failed to address the risk of lost production and implied a contract term to achieve an "equitable result." Persuaded that Chevron and its sublessee, Belco Petroleum Corporation, allocated to Chevron the risk of lost production, we reverse.

I

Chevron is the lessee from the government of an offshore oil lease on the outer continental shelf off the Louisiana coast. In 1971, Chevron and Belco executed a farmout agreement, under which Belco agreed to drill and operate wells on the tract in return for an assignment of the lease, subject to a one-eighth overriding royalty in favor of Chevron, if production was obtained.

Belco obtained gas production and applied to the Federal Power Commission for a certificate of public con-

venience and necessity. In its application, Belco sought FPC permission to sell its gas to Tennessee Gas Pipeline Company at 45 cents per thousand cubic feet, plus small annual increases, rather than the "area rate" of .26/MCF applicable to other producers. Chevron declined to participate in the ratemaking proceedings. The FPC granted Belco's request, conditioned on Belco's promise to "plow back" its .19/MCF of extra revenue into oil and gas exploration in southern Louisiana for ten years or under certain conditions to pass this back through to Tennessee's customers. Belco began selling gas to Tennessee Gas Pipeline in October of 1973.

Belco offered to pay Chevron its overriding royalty in cash, but Chevron, preferring to rely upon its own marketing effort, decided to take its gas in kind. In 1974, Chevron sent Belco a proposed "gas balancing" agreement. This draft provided that if a party did not dispose of its share of gas, the other could take more than its share, but had to maintain a "gas in storage" account reflecting its draw of the other's gas. The underproducing party could at any time choose to begin taking and selling its share, plus 25% of the overproducer's share, until the account was in balance.

Belco misplaced its copy of the proposed agreement, and asked Chevron to send another. Chevron considered sending a different version of the contract containing a "cash balancing" clause, under which the overproducing party would repay the underproducer in cash if the field was depleted with the account out of balance. Chevron's negotiator testified that he thought a cash balancing clause was unnecessary because the field was thought to contain large gas reserves. The district court found that because

"Chevron wanted to avoid the confusion of submitting a different proposal," Chevron sent Belco a copy of the first draft, which omitted treatment of the risk of lost production. Belco signed it without modification on June 6, 1975.

Chevron contracted to sell its share of production to Tennessee Gas Pipeline, and applied for its own FPC certificate in December 1976. The certificate was not issued until October 1979—four months after the field had stopped producing. Having taken no gas in kind, Chevron demanded from Belco a cash payment of one-eighth of the revenues from the sale of the field's gas. Belco refused, and Chevron sued.

After a bench trial, the district court, citing Louisiana Civil Code articles 1903 and 1965, recodified as articles 2054 and 2055,[1] used equitable principles of unjust enrichment to supply the "missing" contract term, and upheld Chevron's claim. The court awarded Chevron one-eighth of the revenues actually received by Belco at its FPC-approved premium price, minus Chevron's share of

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[1] Article 2054:

When the parties made no provision for a particular situation, it must be assumed that they intended to bind themselves not only to the express provisions of the contract, but also to whatever the law, equity, or usage regards as implied in a contract of that kind or neccessary for the contract to achieve its purpose.

Article 2055:

Equity, as intended in the preceding articles, is based on the principles that no one is allowed to take unfair advantage of another and that no one is allowed to enrich himself unjustly at the expense of another.

Usage, as intended in the preceding articles, is a practice regularly observed in affairs of a nature identical or similar to the object of a contract subject to interpretation.

the one-sixth federal royalty, for a judgment of $619,052.85.

II

[1, 2] The district court's resort to equity in concluding that Belco should compensate Chevron in cash for its gas in storage was justified only if the parties did not contractually allocate the risk of lost production. "When the intent of the parties is evident and lawful, neither equity nor usage can be resorted to, in order to enlarge or restrain that intent..." Louisiana Civil Code art. 1963 (1870).[2] The intent of Chevron and Belco, if any, is to be determined only from the words of their contract if that contract on its face is clear, explicit, and leads to no absurd consequences. Louisiana Civil Code art. 1945(3) (1870), *recodified as* art. 2046 (1985). The facial interpretation of the contract is a question of law not subject to the clearly erroneous standard. *Makofsky v. Cunningham*, 576 F.2d 1223, 1229 n. 7 (5th Cir.1978); *Kemp v. Hudnall*, 423 So. 2d 1260 (La.App.1982), *writ denied*, 428 So.2d 474 (La.1983); *Wilson v. Cost + Plus of Vivian, Inc.*, 375 So.2d 683 (La.App.1979).

[3, 4] We read the gas balancing agreement to unambiguously provide the exclusive means for Chevron and Belco to bring their gas account into balance. Paragraph 3 of the agreement states:

To allow the recovery of gas in storage and to

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[2] The newly revised Civil Code articles covering the interpretation of contracts retain this principle. Only when the parties do not provide for a particular situation, La.Civ.Code art. 2054 (1985), or do so ambiguously, La.Civ.Code art. 2053 (1985), may a court turn to equity, usage, or custom.

> balance the gas account of the parties in accordance with their respective interests...a party with gas in storage shall be entitled to take or deliver to a purchaser its current share of the gas produced...plus up to 25% of the other party's share of gas production...until such time as that quantity of gas in storage shall be reduced to zero.

Given this specific designation of a particular method of in-kind balancing as the proper way of reconciling the account, there is no room for the contention that the parties left open the possibility that cash balancing or some other form of balancing might nonetheless be used. Because the contract, on its face, only provided for in-kind balancing, Belco breached no contractual duty to Chevron when it refused to pay Chevron in cash. *See Decker v. Marchese*, 413 So.2d 210 (La.App.1982) (defendant who contracted to make specified repairs to house was not obligated to repair defect not on list).

[5] Chevron notes that in the introduction to the gas balancing agreement, the parties reaffirmed that Chevron was "entitled to own and share in" one-eighth of the gas well's production, and Belco in seven-eighths. It argues that our subscribed reading of the balancing clause deprives it of its ownership of one-eighth of the gas, and deprives the introductory paragraph of the contract of meaning. We disagree. Under this scheme, the underproduced party bore the risk that the gas well would be depleted before the underproducer could produce, and thus own, all or any of its share. Chevron's argument that Belco sold "Chevron's gas" to its pipeline customer is not contractual, but is more of an equitable claim of unjust enrichment—one that cannot supersede the contrary terms

of the contract. *Edmonston v. A-Second Mortgage Co.*, 289 So.2d 116, 122 (La.1974); *McDonald v. Champagne*, 340 So.2d 1025 (La. App.1976).

[6, 7] The district court, by resort to equitable principles of Louisiana law, supplied a contractual provision that Chevron deliberately omitted on the theory that only if both parties intended its omission should equity not so intervene. We have concluded that the executed contract, without the paragraph giving to Chevron a cash option in the event production is lost, on its face allocated the risk of lost production to Chevron. Under Louisiana's four-corners rule, as stated in Civil Code article 2046, the fact that both parties signed an explicit, unambiguous contract is conclusive evidence of their mutual intent. Thus, we reject the district court's underlying premise that because Chevron unilaterally rejected the clause which would have protected it, there was not bilateral agreement as to the risk of lost production.

The court below stated that "it would be absurd to conclude that Chevron waived its right to recoup its share by omitting a cash-balancing clause, in the absence of evidence to that fact." The argument would be that Chevron, which paid $770,000 for an offshore lease, and expressly reserved a one-eighth interest in its sublease, had no reason to sign a contract that created the possibility that it would receive no revenue from the well. We do not think that our reading of the contract yields an "absurd" result in contravention of Louisiana Civil Code article 2046.

The trial court, accepting Chevron's own theory, specifically found that Chevron's motive in intentionally refraining from submitting a cash balancing clause was to

"avoid the confusion of submitting a different proposal." To gain the benefit of lessened confusion, Chevron resubmitted a contract providing only for in-kind balancing, thus taking the risk that the well would deplete and that in-kind balancing would become impossible.[3] In citing to this court its own witnesses' testimony that "the chance that Chevron might not make up in-kind was remote in the extreme," Chevron only confirms that it was reasonable for it to have taken that remote risk to achieve a modest benefit. Although the contract that Chevron proposed was, in retrospect, ill-advised, it was not absurd.

III

Chevron also contends that the gas balancing agreement was a "loan for consumption" under article 2910 of the Louisiana Civil Code, which reads:

> The loan for consumption is an agreement by which one person delivers to another a certain quantity of things which are consumed by the use, under the obligation, by the borrower, to return to him as much of the same kind and quality.

Under article 2921, if the borrower fails to return goods equivalent to those he has borrowed, he must pay the lender the value of the thing lent. Chevron contends that under the gas balancing agreement, Chevron loaned Belco the extra gas that Belco produced, obligating Belco either

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[3] That the contract as signed allocated the risk of lost product to Chevron is implicit in the explanation of the omission of the cash-out clause. Had the contract been identical with and without a cash balancing provision, the "confusion of submitting a different proposal" would have been nonexistent.

to restore the gas or to pay for it.

[8] Although Chevron is correct that gas is a thing that is consumed by its use, and may be an appropriate subject for a consumption loan agreement, the gas balancing contract is not such an agreement. Chevron did not deliver gas to Belco in exchange for Belco's obligation to repay. Rather, Chevron's call was upon production to the partial exclusion of Belco until the accounts were balanced. It was the geologic formation that failed to pay, not Belco.

REVERSED.

APPENDIX C

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

CHEVRON U.S.A., INC.	*	CIVIL ACTION
VERSUS	*	NO. 82-3073
BELCO PETROLEUM CORPORATION	*	SECTION "D" (4)

OPINION

In this controversy, the court is faced with the paradoxical task of determining the legal effects of a "gas balancing" agreement when there is no gas left to balance. The parties to the balancing agreement are Chevron U.S.A., Inc. (Chevron) and Belco Petroleum Corporation (Belco).

FACTS

In 1962 Chevron acquired an oil and gas lease for $770,000 from the United States for Block 84 of the West Delta Area, situated on the Outer Continental Shelf off the Louisiana coast. The United States reserved a 1/6 royalty of all production from the leased area. In 1971 Chevron entered into a "farmout" agreement with Belco, obligating Belco's performance under the farmout, Chevron subsequently assigned its lease to Belco, subject to an overriding royalty of 1/8 in favor of Chevron.

After receiving the assignment, Belco negotiated a gas sales contract with Tennessee Gas Pipeline Co. Before delivering the gas, Belco had to apply to the Federal Power

Commission (FPC—now the Federal Energy Regulatory Commission) for a certificate of public convenience and necessity. In making its application, Belco sought to take advantage of an FPC option allowing Belco to sell its gas at 45 cents/MCF, as opposed to the area rate of 26 cents/MCF. Belco invited Chevron to assist in funding the proceedings before the FPC, but Chevron declined to do so. Belco nonetheless succeeded in attaining the higher rate, conditioned upon its submission to a "plowback" agreement which required Belco to spend $32 million over a 10-year period on oil and gas exploration in the southern Louisiana region. If Belco failed to spend the requisite amount of funds on exploration, the purchasers of the gas would be entitled to a rebate for all gas sold over 26 cents/MCF. By October of 1973, Belco began selling its gas to Tennessee Gas Pipeline.

For short time, Belco held in escrow Chevron's share of the production revenues and offered to periodically pay Chevron its 1/8 royalty. Rather than accepting cash, Belco was informed that Chevron desired to take its share of the gas in kind. Instead, Chevron preferred to independently sell its share of the gas, take advantage of contingent escalations and gamble that the price of gas would rise above 45 cents/MCF. Chevron wanted to avoid being locked-in to Belco's rate structure and the risk that Belco would not honor the plowback agreement.

On January 10, 1974, Chevron submitted a proposed "gas balancing" agreement to Belco which provided that an underproduced party would be entitled to take, in kind, 25% of the overproduced party's share of gas, in addition to its own share, until a balance was achieved. In June of 1975, the agreement was approved by Belco without

modification.

Significantly, the gas balancing agreement did not contain a provision for cash balancing in the event that the field depleted before an in kind balance took place. This void was not a mere oversight. In fact, before the balancing agreement was approved, Belco had misplaced the proposed agreement and requested another copy. Chevron drafted another balancing agreement which did provide for a post-depletion cash balancing. That draft was never forwarded; Chevron wanted to avoid the confusion of submitting a different proposal and sent another copy of the original instead.

William Hill, Chevron's principal in negotiating gas contracts, testified that a cash balancing clause was not thought necessary because of the estimated reserves of gas in the field. The most conservative estimate was 19.8 BCF; a higher estimate, that of Belco, forcasted reserves at 60 BCF.

At the time Chevron informed Belco of its desire to balance exclusively in kind, Chevron was seeking to market its share of the gas and eventually confected its own sales contract with Tennessee Gas Pipeline. On December 10, 1976, Chevron applied with the FPC for the prerequisite certificate of public convenience and necessity. Unfortunately, on June 19, 1979, four months before the certificate was issued—and before Chevron had taken a single cubic foot of gas—the field stopped producing. Total production of natural gas during the life of the field was only 12.2 BCF.

Chevron now seeks to recover, in cash, 1/8 of the

revenues produced from the field.

CONSTRUCTION OF THE CONTRACT

The silence of the gas balancing agreement as to a cash balancing upon depletion of the field brings two principles of contract interpretation into focus.[1] The first principle is best expressed by La. Civ. Code arts. 1903 and 1965.[2] Applying this principle, Chevron urges that either custom or equity supplies the missing terms of this less-than comprehensive contract. *See Fontentot's Rice Drier, Inc. v. Farmers Rice Milling Co., Inc.*, 329 So.2d 494, 498 (La.App. 3d Cir. 1976), *writ denied*, 333 So.2d 239 (La. 1976).

The second principle, the one advanced by Belco, tempers the application of the first. The second principle is embodied in La. Civ. Code arts. 1963 and 1964[3] and stands

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[1] Louisiana law applies to this diversity case.

[2] Art. 1903. The obligation of contracts extends not only to what is expressly stipulated, but also to everything that, by law, equity or custom, is considered as incidental to the particular contract, or necessary to carry it into effect.

Art. 1965. The equity intended by this rule is founded in the christian principle not to do unto others that which we would not wish others should do unto us; and on the moral maxim of the law that no one ought to enrich himself at the expense of another. *When the law of the land, and that which the parties have made for themselves by their contract, are silent, courts must apply these principles to determine what ought to be incidents to a contract, which are required by equity.* (Emphasis added).

[3] Art. 1963. When the intent of the parties is evident and lawful, neither equity nor usage can be resorted to, in order to enlarge or restrain that intent, nor can any law operate to that effect, unless it be some prohibition or other provision, which the parties had no right to

for the proposition that if the contract in question is unambiguous, equity or usage cannot modify the effect of the contract. *See Amoco Production Co. v. Texaco, Inc.*, 415 So.2d 1003, 1006 (La.App. 4th Cir. 1982).

Accordingly, the initial inquiry is the ambiguity *vel non* of the balancing agreement. If the words of the contract are clear, the court looks no farther to give effect to the parties' intentions. *Maloney v. Oak Builders, Inc.*, 256 La. 85, 235 So.2d 386, 390 (1970); *Saucier v. John-Clai Co.*, 408 So.2d 27, 29 (La. App. 3d Cir. 1981). If the mutual intention of the parties is not explicit on the face of the contract, the intent of the parties in formulating the contract becomes relevant. *Kendrick v. Garrene,* 233 La. 106, 96 So.2d 58, 61 (1957). Once the intent is discerned, the court can give legal effect to it.

INTENT OF THE PARTIES

While the existing terms of the balancing agreement are clear and explicit, it would be an oversimplification to say the contract is unambigious. The contract does not provide for a post-depletion balancing; the court must look beyond the words of the balancing agreement to determine how the parties intended to handle this situation. Thus, the question becomes whether the parties, by providing for in kind balancing only, intended to preclude a cash balancing in the event that the field depleted before an in kind balancing was accomplished.

(footnote 3 continued)
modify or renounce.

Art. 1964. Equity, usage and law supply such incidents only as the parties may reasonably be supposed to have been silent upon from a knowledge that they would be supplied from one of these sources.

Belco contends that Chevron was aware that the field could run out sooner than expected and assumed the risk of impossibility. Whether Chevron assumed the risk of impossibility is irrelevant unless both parties intended that to be the case. I reject the broad reading Belco gives *Morgan & Lindsey v. Ellis Variety Stores,* 176 La. 198, 145 So. 514 (1932), cited for the "risk of impossibility" argument. In that case, a flood caused by a crevasse in the levee on the bank of the Mississippi River prevented the inventory of a store, a condition precedent to the sale of the store. Morgan & Lindsey had to forfeit the earnest money it had deposited because both parties knew upon entering into the contract there was a great danger of flood. *Id.* at 520. Such is not the case in the instant matter; neither party knew or expected the field to deplete so soon. See pp. 3-4 *infra.*

Citing *Smith v. Tullos,* 195 La. 400, 196 So. 912 (1940), Belco further contends that the court can not provide the very term Chevron obviously sought to excise from the contract. In *Smith*, the parties to an oil and gas lease agreed to strike a certain clause in a printed form contract pertaining to the drilling of other wells after drilling a test well. Through an oversight, the entire clause was not striken. The lessor later sought to enforce the subject clause after the test well was a dry hole. The Court held that there was no implied obligation to continue drilling where there was an agreement that no such obligation should exist. *Id.* at 913. Nevertheless *Smith* is distinguishable from the case at bar; the parties in *Smith* specifically addressed the contingency which in fact arose and their intentions were clear. Conversely, the uncontroverted testimony in the instant case demonstrates that the parties never discussed what would happen if the field

depleted before an in kind balancing occured. To be sure, the absence of the cash-balancing clause was not inadvertant, but rather a deliberate decision on behalf of Chevron. But it would be absurd to conclude that Chevron waived its right to recoup its share by omitting a cash-balancing clause, in the absence of evidence to that fact.

When the law the parties have made for themselves is silent as to what ought or ought not to be an incident of the contract, the court is bound to apply equitable principles. La. Civ. Code art. 1965; *Louisiana Power & Light Co. v. Town of Arcadia, 119 F.Supp. 818, 821 (W.D. La. 1954).*[4] *"[T]he 'most congruous' result is always to be presumed and the intention to impose harsh and inequitable burdens is never implied."* *Illinois Central Railroad Co. v. Gulf, Mobile & Ohio Railroad Co.,* 191 F.Supp. 275, 278 (E.D. La. 1961), *aff'd.*, 308 F.2d 374 (5th Cir. 1962). The most congruous result in this case is to imply that a cash balancing is proper when an in kind balancing is impossible.

PRESCRIPTION

The instant suit was filed on June 17, 1982. If this

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[4] The five prerequisites to maintaining an *actio de in rem verso* (i.e., an enrichment, an impoverishment, a connection between the enrichment and impoverishment, an absence of "justification" or "cause" for the enrichment and impoverishment, and lack of a legal remedy) are satisfied in this case. The only factor subject to any debate is that of "justification" or "cause". The presence of an implied or express contract that justifies the enrichment is essential to a finding of "cause". *Edmonston v. A-Second Mortgage Co. of Slidell, Inc.,* 289 So.2d 116, 122 (La. 1974). Since I find that neither the express contract or the intent of the parties addressed the contingency that arose, it follows that a justification for the enrichment is lacking. In other words, Chevron did not "contract away" it share of the gas.

suit were merely for the failure to pay royalties, the liberative prescription of La. Civ. Code art. 3538[5] would apply.

However, the rights which Chevron seek (sic) to assert, as evinced by the petition, are based on an accounting due under the balancing agreement and the doctrine of unjust enrichment, rather than the assignment to Belco which reserves the overriding royalty or "rental." Insofar as prescription is *stricti juris*, the character of the action between the parties must be examined to determine the applicable prescriptive period. *Duer & Taylor v. Blanchard, Walker, O'Quin & Roberts,* 354 So.2d 192, 194 (La. 1978). Obviously, the parties intended that their relationship be governed by the balancing agreement, and not the assignment. The parties would not have confected another contract if the assignment satisfied their needs. Considering the controlling effect of the balancing agreement, this suit is not one for rent. Hence, the ten-year prescription period of La. Civ. Code art. 3544 is applicable.

AMOUNT OF RECOVERY

Belco argues that it is unfair for Chevron to take ad-

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[5] Art. 3538. The following actions are prescribed by three years:

That for arrearages of rent charge, annuities and alimony, or of the hire of movables and immovables.

* * *

...This prescription only ceases from the time there has been an account acknowledged in writing, a note or bond given, or an action commenced.

The reservation of an overriding royalty in the assignment actually created a sub-lease. Hence, the overriding royalty is considered a rental. *Bond v. Midstates Oil Corp.,* 219 La. 415, 53 So.2d 149 (1951); *Hankamer v. Texaco, Inc.,* 387 So.2d 1251 (La. App. 1st Cir. 1980).

vantage of the favorable price for gas Belco attained after Chevron refused to assist in funding the proceedings before the FPC or participate in the "plowback" obligation. On the other hand, Chevron was correct in predicting that gas prices would rise above 45 cents/MCF. Even before the field depleted, the FPC increased the area rate to 50 cents/MCF, subject to certain escalations. Since it cannot be determined exactly what price Chevron could have sold its share of the gas for, the court finds that the most equitable solution is to use the price that Belco received for its share.

During the life of the field (October 1973-June 1979) Belco sold to Tennessee Gas Pipeline Co. 12,214,634 MCF of gas and received $5,942,907.39.[6] Chevron's 1/8 royalty amounts to $742,863.42. When the 1/6 royalty of the United States, which both parties are obligated to pay, is subtracted from Chevron's share, the remaining amount owed to Chevron is $619,052.85.

Accordingly, let there be judgment in favor of Chevron and against Belco in the amount of $619,052.85 plus legal interest in accordance with Louisiana law.

New Orleans, Louisiana, this 30th day of April, 1984.

/s/ A.J. McNamara
UNITED STATES DISTRICT JUDGE

[6] Beginning in October of 1973, Belco received under its contract with Tennessee Gas Pipeline 46c/MCF, subject to an annual increase of 1.5c/MCF. By June 1979, Belco was receiving 54c/MCF.

APPENDIX D

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF LOUISIANA

CHEVRON U.S.A., INC.	CIVIL ACTION
VERSUS	NO. 82-3073
BELCO PETROLEUM CORP.	SECTION "D"

JUDGMENT

This matter came on for trial before the Court on a previous day.

After hearing the evidence, the Court took the matter under submission.

NOW, THEREFORE, for the written reasons of the Court on file herein, and considering the direction of the Court as to the entry of judgment; accordingly,

IT IS ORDERED, ADJUDGED AND DECREED that there be judgment in favor of Plaintiff, Chevron U.S.A., Inc. and against defendant, Belco Petroleum Corp., in the amount of $619,052.85, plus legal interest in accordance with Louisiana law, plus costs.

Dated at New Orleans, Louisiana, this 7th day of May, 1984.

/s/ A.J. McNamara
UNITED STATES DISTRICT JUDGE

Arthur P. Mitchell, Esq.
H.H. Hillyer, Jr., Esq.
Ewell E. Eagan, Jr., Esq.

APPENDIX E

GAS BALANCING AGREEMENT

This Agreement is made as of October 1, 1973 by and between Chevron Oil Company, The California Company Division (Chevron), and Belco Petroleum Corporation (Belco), in conjunction with that certain Farmout Agreement between Chevron and Belco dated August 4, 1971, as amended by that Letter Agreement dated October 12, 1971.

The parties hereto agree that they are entitled to own and share in the following percentages:

Belco	87.5000%
Chevron	12.5000%
Total	100.000%

in the oil and gas production from Block 64, West Delta Area, United States Department of Interior Lease No. OCS-G-1077, as provided for in the above-mentioned Farmout Agreement.

Each party has made or will make arrangements to sell or utilize its share of the gas produced from said lease. However, either of the parties may be unable to take or market its interest in the gas production from time to time; therefore to permit each party to produce and dispose of its interest in the gas production from the lease with as much flexiblity as possible, the parties hereto agree to the storage and balancing arrangement herein set forth.

1. From and after the date of initial delivery of gas from the above-mentioned lease, during any period when a party does not dispose of its full share of the gas produced

from said lease, during any period when a party does not dispose of its full share of the gas produced from said lease, the other party may produce from said lease and take or deliver to a purchaser, each month, all or part of that portion of the allowable gas production assigned thereto by the U.S.G.S. or its successor, which is not produced by the party taking less than its full share. The parties hereto shall share in and own the liquid hydrocarbons recovered from such gas in accordance with their respective interests, as set forth hereinabove.

2. A party taking less than its full share of the gas produced shall be credited with gas in storage equal to its full share of the total gas produced, less such party's share of the gas used in lease operations or vented or lost, and less that portion of the gas such party took or delivered to its purchaser. Belco, as Operator of the field, will maintain an acount of the gas balance between the policies hereto and will furnish Chevron monthly statements showing the total quantity of gas produced, the portion thereof used in lease operations, vented or lost, the total quantity of gas taken or delivered to market for the account of each party, and the monthly and cumulative over and under delivery of each party.

3. After notice to the other party, either party may at any time begin taking or delivering to a purchaser its full share of the gas produced (less such party's share of gas used in lease operations, vented or lost). To allow the recovery of gas in storage and to balance the gas account of the parties in accordance with their respective interests, as set forth hereinabove, a party with gas in storage shall be entitled to take or deliver to a purchaser its current share of the gas produced (less such party's share of gas used in

lease operations, vented or lost,) plus up to 25% of the other party's share of gas production as set forth hereinabove, until such time as that quantity of gas in storage shall be reduced to zero.

4. Nothing herein shall be construed to deny any party the right, from time to time, to produce and take or deliver to its purchaser its full share of the allowable gas production to meet the deliverability tests required by its purchase. Each party, shall at all times, use its best efforts to regulated its takes and and deliveries from said lease so that said lease will not shut in for over producing the allowable, if any, assigned thereto by the regulating body having jurisdiction.

5. Each party producing and taking or delivering gas to its purchaser shall pay any and all royalty and production taxes due on such gas.

In witness whereof, this instrument is executed as of the day and year first above written.

BELCO PETROLEUM CORPORATION

By /s/ Paul R. Stewart
Vice President

CHEVRON OIL COMPANY, THE CALIFORNIA COMPANY DIVISION

By /s/ W.R. Mendenhall
Vice-President

By /s/ E.P. Johnson
Assistant Secretary

Art. 2046. No further interpretation when intent is clear

When the words of a contract are clear and explicit and lead to no absurd consequences, no further interpretation may be made in search of the parties' intent.

Art. 2054. No provision of the parties for a particular situation

When the parties made no provision for a particular situation, it must be assumed that they intended to bind themselves not only to the express provisions of the contract, but also to whatever the law, equity, or usage regards as implied in a contract of that kind or necessary for the contract to achieve its purpose.

Comments

(a) This Article is new. It changes the law, making the rule of C.C. Art. 1903 (1870) a rule of interpretation rather than one of substantive law.

(b) This Article provides for the instance where the contract is not ambiguous or doubtful, but simply fails to address a particular question.

(c) This Article enhances the rule stated in the second sentence of C.C. Art. 1965 (1870), which has been accorded insufficient recognition because of its location.

(d) Planiol comments on Article 1135 of the French Civil code, equivalent to C.C. Art. 1903 (1870), as if it were C.C.Art.21 (1870), which provides, in effect, that the court must act as law-maker when the statutory law is silent.

Under this Article, the court must act as law-maker when the statutory law is silent. Under this Article, the court is given the same discretion in the context of contractual interpretation, since no situation may be regarded as unregulated by the legal order. See 6 Planiol et Ripert, Traite pratique de droit civil francais 485 (2nd ed. Esmein 1952).

Art. 2055. Equity and usage

Equity, as intended in the preceding articles, is based on the principles that no one is allowed to take unfair advantage of another and that no one is allowed to enrich himself unjustly at the expense of another.

Usage, as intended in the preceding articles, is a practice regularly observed in affairs of a nature identical or similar to the object of a contract subject to interpretation.